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Morgan, George Wilson

Why the state of New York should continue to...

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Why the State of New York should continue to Prohibit Corporate Encroachments upon the Powers of Trust Companies to Act in Representative and Fiduciary Capacities.

An argument in opposition to the Marshall-Adler bills (Sen. Pr. 1349, 1350; Ass. Pr. 1752, 1753) entitled "An act to amend the Code of Civil Procedure in relation to appointment of State and National Banks as Executors, Administrators or Trustees", and "An Act to amend the Banking Law in relation to appointing State and National Banks as Executors, Administrators or Trustees", presented at a joint hearing of the Committees on Banks and Codes of the Senate by

George W. Morgan (of Breed, Abbott & Morgan,
32 Liberty Street, New York City),
Counsel to Trust Companies Association of the State of New York.

By the provisions of the Marshall-Adler bills (Sen. Pr. 1349, 1350; Ass. Pr. 1752, 1753) it is proposed to amend the Banking Law and the Code of Civil Procedure. The code amendments would authorize the official designation of state and national banks as executor, administrator or trustee, authorize their appointment as trustee by any written instrument, "or otherwise", and would provide that no bond or other security should be required by any court or officer from any such bank when acting in any of these capacities. The amendments to the Banking Law would add a new

subdivision to the section which sets forth the powers of state banks (section 106), and would authorize such banks to act as executor, administrator or trustee; they would also except national and state banks from the prohibitions against encroachments upon certain powers of trust companies now contained in section 223. If thus excepted, national banks would be free, so far as state law is concerned, to exercise the following powers, now confined to trust companies, which are not included in the specific powers granted to state banks by the proposed amendments:—to act as fiscal and transfer agent, registrar of evidences of indebtedness, attorney in fact and agent, guardian, receiver or committee, depositary of moneys paid into court, and *in "any other fiduciary capacity."*

The Evans bill (Ass. Pr. 1826) now in the Assembly and not now before you, confines its amendments to section 223 of the Banking Law, but would so amend this section that state and national banks, *provided they owned stock in a federal reserve bank,* might exercise the powers of trust companies generally.

It is obvious that the purpose of including state institutions at all is merely to breach the united opposition of state moneyed corporations. It might be stated, however, in passing that one of the effects of these amendments to the Banking Law would be to discriminate against state banks in favor of the national banks; but a discussion of this phase of the bills will be left to our state commercial banking institutions.

The Federal Reserve Board at Washington through formal resolution has expressed itself as being in "entire sympathy and accord with the efforts of those" who stand as sponsors for these bills,—at least in so far as they are applicable to

national banks. Mr. Paul Warburg, speaking for the Federal Reserve Board, urges the granting of trust powers to national banks as a sort of consideration for the privileges which the Federal Reserve Law offers to state institutions. He states that the problem confronting the Reserve Board would not be difficult if trust companies had not invaded the field of commercial banking and that the Reserve Board wishes to be fair both to the national and state institutions. Mr. Stuart Gibboney, who represents the federal reserve bank of this district, and who frankly stated on March 30th, in the hearing room of the senate committee on banks, that he was in Albany to favor this legislation at the suggestion of Mr. John Skelton Williams, the Comptroller of the Currency, has evidently become somewhat alarmed at the extent of the resentment aroused against federal interference in state affairs, and now states in print that he represents no one except certain national banks in this state which are clients of his. The office of the Secretary of State contains no record as yet as to the identity of these clients. It has not yet been made clear in what capacity Mr. Leslie R. Palmer, a director of the federal reserve bank of this district, appears in favoring these federal encroachments upon the powers of the state.

It is evident from the published remarks of Mr. Warburg that the "fair and liberal" policy of the Federal Reserve Board toward our trust companies contemplates equipping national banks with trust powers because, as he states, some trust companies have entered the field of commercial banking. Mr. Warburg is not often given to fallacious reasoning. His opinions on banking questions should always receive serious consideration. In the present instance, however, a slight

examination of his contention will show that the reasons assigned by him are untenable both in logic and in equity.

Should national banks receive from the states the power to act as executor, administrator and trustee because some trust companies have entered the field of commercial banking? As we shall show later, the Supreme Court of the United States has held in well considered decisions that the exercise of fiduciary powers by a trust company is not in any sense a banking function. Some of our trust companies in New York and many in other states, are empowered, under their charters, to insure titles to real estate. Does this fact of itself make it desirable to permit commercial banks to engage in the business of insuring such titles? Does insuring real estate titles constitute any part of the business of commercial banking? Why not bestow upon commercial banks all of the powers which any trust company may exercise, inasmuch as trust companies have in some instances taken commercial accounts and discounted commercial paper? Does it follow that because some lawyers are also engaged in business enterprises that all business men should be admitted to the bar?

The chairman of your banking committtee, Senator Marshall, on the other hand, does not join in the solicitude of the Federal Reserve Board for those national banks which have existed for many years in the same communities with trust companies. If we understand his position correctly, his reasons for introducing and favoring the proposed legislation are based upon what he conceives to be the interests of the rural districts and the smaller communities in our state. Such communities, he argues, have no trust companies and it is highly desirable, if

not indeed necessary, that there should be accessible to such communities some form of corporate organization which can act in the capacity of executor, administrator or trustee. The obvious answer to Senator Marshall's position is contained in our Banking Law. Section 180 of this law provides that a trust company may be organized in any community which does not exceed 25,000 population, with a capital of not less than $100,000. The Peoples National Bank of Malone, New York, of which Senator Marshall is president, has a capital of $150,000 and a surplus in excess of twice that amount. The village of Malone has a population approximately of 8,000 people. The village of Northport in Suffolk County, with a population not greatly in excess of 2,000 contains a trust company as well as a state and a national bank. It is apparent, therefore, that the capital requirements of the existing trust company law do not prevent the organization of trust companies in the rural counties of our state. It is submitted that Franklin and Suffolk counties are fairly typical illustrations of rural counties. Examples might be multiplied of rural counties which maintain both national and state banks with capital and surplus in excess of the minimum requirements for the organization of trust companies.

The question naturally arises, therefore, why the inhabitants of such communities, if desiring to exercise trust powers in corporate form, should be unwilling to avail themselves of the provisions of our Banking Law instead of attempting to engraft trust powers upon the powers of national banks. There are two answers to this question. From the standpoint of the partisans of the federal administration it is the federal reserve system which they are seeking to strengthen, and

the most obvious way to accomplish such purpose is to make the charters of national banks more attractive than those of state institutions. From the standpoint of the bankers in rural communities, the prospect is held out to them by this proposed legislation of obtaining enlarged powers without any added statutory restrictions upon their methods of doing business and without any additional capital requirements.

Let us see whether Mr. Warburg's proposition is equitably sound. The extension of trust powers to national banks is desirable, he argues, in order that the Federal Reserve Board may be fair in dealing both with the national and state institutions. The exercise of trust powers by national banks in competition with trust companies must of necessity, produce commercial inequity.

Trust companies under our state law are required to have a minimum capital of $100,000 in communities which do not exceed 25,000 population; $150,000 in cities from 25,000 to 100,000; $200,000 in cities with a population in excess of 100,000 and up to 250,000; and $500,000 in cities in excess of 250,000. None of their capital may be invested except in public securities of the state, of the United States, or of counties or cities of the state of New York, or in bonds and mortgages on New York real estate where the mortgages are first liens and do not exceed sixty per cent of the value of the property. A substantial proportion of their capital invested in public securities must be delivered to and registered in the name of the Superintendent of Banks in trust for their creditors. A statutory interest rate on trust funds is required to be credited and accumulated for the benefit of the beneficiaries unless distributed under the terms of the trust. For the protection of the beneficiaries of trusts, the debts owed by a

trust company to such beneficiaries are entitled to preferential payment from its assets.

None of these restrictions, wisely imposed upon the exercise of these fiduciary powers for the protection of those dealing with trust companies are imposed either upon state banks under our Banking Law or upon national banks under the National Bank Act or under the Federal Reserve Act. Furthermore the proposed amendments contain no provisions making these salutary restrictions applicable to these new recipients of the state's favor; and while trust companies may be required to furnish security upon application (section 188, Banking Law, subd. 6) for the faithful performance of their fiduciary obligations, the Marshall-Adler bill specifically forbids the requiring of such security from national or state banks.

National and state banks, on the other hand, may be organized in the smaller communities with a capital of $25,000, or twenty-five per cent of the minimum capital of trust companies. The largest capital required of national or state banks is $100,000, or twenty per cent of the maximum capital required of trust companies. A state bank, even in the largest cities, is required to deposit with the Superintendent of Banks securities to the amount of only $1,000 to cover penalties for violation of the provisions of the Banking Law, or one-twentieth of the minimum amount which the law requires trust companies to deposit with the Superintendent of Banks. National banks are not required to make any deposit of securities whatever except to secure government deposits and circulation. State and national banks are subject to no special restrictions in their capital investments. There are no statutory preferences, either under the state or national law, similar to

the preferences existing in favor of beneficiaries in the case of trust companies.

The Marshall bill proposes to permit national and state banks to exercise trust powers with no guaranty that any of the restrictions now applicable to trust companies will ever be imposed upon national banks by the Federal Reserve Board when such powers are entrusted to them. It does not require an expert in political economy to prophecy the effect of such a policy upon the continued supremacy of the trust companies of New York State. Self-preservation will require them to throw off the hobbles which retard them in the competitive struggle. In other words, the competition of the national banks will force the trust companies out of our state banking system and compel them to nationalize,—to the incalculable damage of our great state banking system, and to the serious detriment of efficient responsible corporate management of trust property. Mr. Warburg has stated that he has no reason to think that there is any desire on the part of the Board to "nationalize" state banks. Although he does not include trust companies in the above statement, we shall assume that he intended the term "state banks" to include trust companies. In law, a man is presumed to intend the consequences of his acts. As has been shown, the nationalization of trust companies would be inevitable were the provisions of the Marshall bill put into effect. If it is the intention of the Federal Reserve Board to deal equitably with state institutions, such intention can hardly be gleaned from the Reserve Board's active sympathy with proposed legislation in the various states of the character of the Marshall bill.

As a result of the studied protection thrown around corporate fiduciary relationships by the

State of New York we never hear of losses to beneficiaries of corporate trustees through the insolvencies of such trustees. Is it wise from the standpoint of state policy to publish to the world that the state of New York has withdrawn the safeguards from, and lowered the standards of, corporate trusteeship in our state? It is not by accident that our trust companies in the state of New York have grown so that their combined assets equal almost one and three-quarters billions of dollars, and that their deposits are almost twenty-five per cent of the entire deposits of all the national banks in the United States, and exceed the total deposits of all the national banks in the state of New York. The consequences to the financial supremacy of New York which will result from thus reversing our state policy toward corporate trusteeships should be seriously considered before it is too late to repair the damage.

Nor should we hastily surrender our system of supervision of the manner in which corporate trustees in the state of New York are fulfilling their obligations, to a federal bureau located in the District of Columbia. The system of state supervision is statutory, and in case of violations of orders of the supervising officials of our state, the power is reserved to the state which gave corporate life to take it away, to assume possession of the corporation's property, and to protect its beneficiaries. But it the power of regulation of the administration of trusts and estates is transferred to Washington, the rules and regulations governing their supervision may be changed at the whim or caprice of the Federal Reserve Board; and the state of New York will be powerless to remedy any violations by national banks of their fiduciary obligations or to protect the beneficiaries of trusts created within its own borders.

Our state Banking Law has protected all moneyed corporations from encroachments upon the exercise of powers derived from the state. Each moneyed corporation of any particular class under this law obtains the same powers, is required to have the same amount of minimum capital, and is subject to the same restrictions in the exercise of its powers. The state has said in effect that it will not countenance, so far as it can prevent it, competition with its moneyed institutions until the institutions proposing to compete have complied with the same requirements demanded of existing state institutions. Such an attitude is primarily fair, and is keeping faith with those who have invested their capital in moneyed corporate enterprises in our state. Under this system of protection the commercial banks and trust companies under the jurisdiction of our Banking Department have contributed materially to the financial supremacy of New York, and have built up throughout the entire United States a remarkable confidence in the financial stability of our state moneyed institutions.

Moreover, the proponents of the Marshall bill cannot fairly criticise this state policy of protecting its own institutions. The Federal Reserve Act is bristling with provisions designed to protect member banks in the exercise of their powers. It prohibits member banks from acting as the medium or agent of non-member banks in obtaining privileges under the act without the permission of the Federal Reserve Board. State institutions becoming member banks must comply with the reserve and capital requirements of the federal law and submit to examinations and regulations of the Federal Reserve Board. They must

conform to the federal law respecting the limitation of liability of single persons, the prohibitions against making purchases of, or loans on, their stock, the withdrawal or impairment of capital, the payment of unearned dividends, and all rules and regulations in relation to such matters promulgated by the Federal Reserve Board. They also subject themselves to the federal penalties for violations of the National Bank Act. Under the provisions of the Clayton Act, the officers, directors and employees of a state member bank become subject to its drastic provisions against interlocking directorates. No reasonable objection can be urged against imposing these uniform restrictions upon the exercise of common privileges. This legislative policy of preventing encroachments on the statutory powers conferred, however cannot be fair and proper in the federal jurisdiction but unfair to the federal system when practiced by the state.

The federal government favors its own institutions by confining its deposits of government moneys to such institutions. The state, on the other hand, has dealt impartially with the national banks within its borders and is accustomed to make liberal deposits of state funds in such institutions. The existing prohibitions against national banks encroaching upon the powers of trust companies are not confined to federal moneyed corporations, but are equally applicable to state commercial banks.

The state has further evidenced its friendliness toward the federal reserve system by so amending its Banking Law as to permit state banks and trust companies to purchase qualifying shares in the federal reserve banks (Sections 106, 185). An amendment was also inserted in the revision of 1914 which provided that state banks or trust

companies which became member institutions could count the reserves carried with the federal reserve bank pursuant to the reserve act, as part of their total reserves. (Sections 112, 197). This provision prevented the handicapping of member state banks in competing with non-member state institutions. Our Banking Law, in fact, affords every facility to state institutions to join the federal reserve system. Whether such institutions elect to become member banks depends entirely on how they view the relative advantages or disadvantages of such membership. By electing to become member banks, they suffer no deprivation at the hands of the state of any of their rights.

Surely no one can in justice claim that the state of New York has not dealt fairly and in a spirit of co-operation with the federal government in thus removing all state barriers which might have impeded a thorough test of the sufficiency of the federal reserve system. The provisions of the Marshall bill, however, would require the state to go further and permit national banks to exercise fiduciary powers in our state *on more favorable terms than state institutions.* The adoption of such a suicidal policy is hardly conceivable.

The proposed legislation is inimical to the fiscal interests of our state. In the fiscal year 1914, the state of New York received in annual franchise taxes from trust companies the sum of $2,340,000 out of a total of $11,634,000 received from corporations generally for annual franchise and license taxes. It is beyond the power of the state to assess a franchise or license tax against a national bank. The state can, therefore, never derive any revenue from national banks by taxing the privilege, if accorded it, of acting in a fiduciary capacity. At a time when the fiscal officers of the state are searching for additional sources of in-

direct revenue to meet the expenses of state government, it is a questionable conservation of such sources to endow national banks gratuitously with functions from which the state can derive an income from the exercise of such functions by its own institutions.

The capital investments of our trust companies have absorbed many millions of dollars of the state's obligations. The demand for these securities has been much quickened by the tremendous purchasing power of the combined trust company capital of our state. It has thus been possible to float state securities at a moderate interest rate with a resulting benefit to the state treasury. Our legislature has, at times, resorted to questionable expedients to stimulate artificially the market for state securities. It certainly should not adopt a policy of destroying one of the largest active bidders for these securities, which would be the inevitable result of the passage of the Marshall bill.

No reasonable necessity can be shown for the enactment of the proposed legislation. Our Banking Law provides an orderly procedure under which existing banking institutions, whether national or state, may be converted into trust companies. This procedure, however, involves the continued maintenance of the trust company standards at present in force in our state. When such a simple method of obtaining trust powers is available both to national and state banks, why lower the standards of corporate fiduciaries or enhance the value of a national bank franchise at the expense of our state banking system?

If the national banks are determined to attempt to obtain the power to act as executor, administrator and trustee in the state of New York, the ques-

tion naturally arises, why come to the state legislature for this privilege? If national banks may constitutionally exercise such power why should not Congress confer this privilege upon the corporations of its creation? Would not the elimination from paragraph K of section 11 of the Federal Reserve Act of the words "when not in contravention of state or local law" make it unnecessary to petition further our state legislatures. The Supreme Court of the United States has thrown considerable light on these questions. In the cases of McCulloch *v.* Maryland (4 Wheat. 377, 379), Osborn *v.* Bank of U. S. (9 Wheat. 738) and Easton *v.* Iowa (188 U. S. 229) it has been held that Congress possesses the power to endow corporations with banking powers because the business of banking is quasi-public in character, is properly a governmental function and that, therefore, the delegation of such power is authorized by implication. In the cases of Mercantile Bank *v.* Mayor, etc. (121 U. S. 159) and Jenkins *v.* Neff (186 U. S. 237) the same court has held that the business peculiar to trust companies—acting as executor, administrator, trustee, registrar, transfer agent, guardian, etc., is *not* a banking function, and that the inherent nature of trust business is not altered by reason of some trust companies having assumed to exercise banking powers. The administration of estates, the execution of trusts and agencies of various sorts, bear no relation whatever to any federal function. They are purely private activities, the regulation and supervision of which have never been delegated to the federal government by the states and belong to the powers reserved to the states by the tenth amendment to the federal constitution. This is the obvious reason why those who seek to obtain these trust privileges for national banks have not resorted to Congress.

Congress lacks the power to bestow such privileges. The attempted exercise of such power by a national bank, even with the specific permission of the state in which it has its domicile, constitutes an *ultra vires* act and clouds the whole transaction with illegality.

The state of New York should not be stampeded into placing the administration of estates of decedents and the execution of trusts into the hands of those whose right to act in a representative or fiduciary capacity is open to such serious doubt. There is no existing necessity which requires undue haste in advancing legislation of this character. In any event, is it not the part of wisdom to await the testing of such power in the hands of national banks in some other jurisdiction so that no uncertainty will be cast upon the corporate administration of trusts in the great state of New York?

The federal reserve system is in the early stages of development. If it ultimately proves to be the solution of our banking problems, state moneyed corporations will seek to avail themselves of its advantages by becoming member banks. Its early success, however, will be retarded rather than promoted by a policy, exemplified in the Marshall bill, which seeks indirectly, by legislative compulsion, to force the decision of state institutions to enter the federal system. But when the effect of such legislation is, as we have shown, to destroy our great state trust company system, if not indeed our commercial banking system as well, resentment should be decisively manifested against this character of federal interference, not only by our moneyed institutions, but by all who have the welfare of our state at heart.

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